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## South Dakota

Legislative, judicial and executive developments

**S**outh Dakota trust law has changed over the last few years. Let's focus on the legislative, judicial and executive branch actions that have generally affected trusts and trust companies.

Each year, South Dakota's legislature reviews its trust and trust company law and passes updated legislation. Nineteen years ago, the South Dakota Governor's Task Force on Trust Administration (Governor's Task Force) was created. It meets annually and submits proposals to the legislature to keep trust and trust company laws modern and developed. As most readers know, South Dakota has been traditionally rated as a top tier jurisdiction for its trust laws<sup>1</sup> and is recognized for its dynasty trust, asset protection trust and decanting laws. Additionally, South Dakota now has chartered approximately 100 public and private non-depository trust companies, with over \$300 billion in assets under management (AUM) (not counting state or national bank trust departments that also have substantial AUM in the state), making the state one of the top for most state-chartered trust companies in the nation.

### Legislative Action

On the legislative scene, in 2019, the trust task force bill (SB 51) had fewer substantive changes than previous years. South Dakota had in the last three years added "special spousal" trusts to allow community property trusts (SDCL 55-17, added in 2016), updated and rewritten its virtual representation statutes (codified as SDCL

55-18 in 2017 and updated in 2018) and revamped its laws to amend its statutes on non-charitable purpose trusts and to include hybrid purpose trusts (SDCL 55-1-20 to 55-1-22.6 in 2018).

**Special spousal trusts (2016).** In 2016, the legislature added South Dakota's version of the community property trust, similar to Alaska's, which was first enacted in 1998 (codified as SDCL 55-17).<sup>2</sup> By following the statutory provisions, South Dakota now recognizes the validity of the special spousal trust and declared that property conveyed to the trust is "community property" and the trust is "considered a trust established under the community property laws of South Dakota."<sup>3</sup> The statutes describe attributes of the property transferred to the trust, including provisions that unless the parties otherwise specifically agree, each spouse is attributed interest in 50% of the special spousal property.

**Virtual representation (2017 and 2018).** In 2017, the legislature recodified South Dakota virtual representation law (now codified under SDCL 55-18), adding definitions and addressing whether a representative can bind a person subject to a trust and who's excluded from the requirement of service or notice (including unborn persons, unascertained persons, potential appointees of a power of appointment (POA), potential takers in default of a POA, uninterested beneficiaries and persons bound by a representative). For the most part, South Dakota kept intact much of its pre-2017 law, but eliminated, for example, provisions that both parents had to be representatives of a minor. The law now only requires one parent to virtually represent a minor and clarifies that no notice is required for unborn children. Thus, the need for appointment of a guardian ad litem is substantially decreased. The statutes also make clear that persons having substantially identical interests with respect to the matter in question can represent other beneficiaries.

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The recodification addressed both judicial and non-judicial proceedings and allows representatives to opt out of being representatives and to represent any number of persons. The new codification also addressed representatives' conflicts of interest and the timely disclosure of any such conflict.<sup>4</sup> A representative may, under the new legislation, be entitled to reasonable compensation, and the legislation preserves the court's authority to appoint representatives (court-appointed guardians ad litem for minors) in certain circumstances—although a guardian ad litem won't be required in most cases, and the court would need to exercise this authority only in unusual cases.

### One of the significant 2019 changes provides procedures for vacation of a trusteeship when a trustee resigns.

The statutes give virtual representatives broad discretion but eliminate liability unless the representative acts dishonestly, with an improper motive, or fails to act if under duty to act. They further provide that the virtual representative isn't a fiduciary unless otherwise ordered by the court or provided in the governing instrument.

The 2017 changes restrict a settlor's right to be a virtual representative if the proposed modification would constitute retained interests or irrevocable transfers under Internal Revenue Code Sections 2036 and 2038. The updated statutes also allow the governing instrument to require additional notifications or consents or to identify those who may not be virtual representatives. Trust protector powers to serve as, designate or remove virtual representatives were also added.

In 2018, certain virtual representation provisions were updated and clarified. If the application of the rules would result in no one being notified (for example, because all of the trust beneficiaries aren't yet born), then someone still must be notified, and the

statutes were revised to detail how to provide such notice. Further, out of the laundry list of potential representatives in different situations, it will often arise that more than one category of representatives can act on behalf of a trust beneficiary. When that occurs, unless otherwise provided, the individual carrying out the notice may exercise discretion in selecting which representative category to use to provide the required notice or obtain the required consent. The procedure for notice on virtual representatives for court proceedings, as well as granting powers of conservators to act as virtual representatives, was also updated. The 2018 changes also clarified that the notice requirements to otherwise defined "qualified beneficiaries" allow notice to a virtual representative.

**Purpose trust additions (2018).** The 2018 legislative changes to purpose trusts are codified as SDCL 55-1-20 to 55-1-22.6. If a purpose trust fails to qualify as a charitable trust, it's called a "noncharitable purpose trust" under South Dakota law. These aren't enforced by the Attorney General's office; instead, an "enforcer" is named within the trust to enforce the trustee's duties. If the instrument fails to name an enforcer, then a court can appoint one. The 2018 statutes also clarified how noncharitable purpose trusts work and the duties of an enforcer. The statutes designated the enforcer as a fiduciary. The statutes also provided for the removal of an enforcer who's failing to discharge his responsibilities. The updates also clarified how a noncharitable purpose trust works if individual beneficiaries are also named (a hybrid purpose trust) and statutorily recognized such a hybrid purpose trust.

**2019 legislative changes.** This year, the legislature had fewer changes than usual. All of the 2019 statutory changes took effect July 1, 2019. One of the significant 2019 changes provides procedures for vacation of a trusteeship when a trustee resigns.<sup>5</sup> Although the trustee must still use efforts to find a successor trustee, if the beneficiaries, settlor and others interested in the trust have simply abandoned the trust, the statutes give the trustee a procedure to resign from the trusteeship and serve only as a custodian of the assets or transfer them to the court. A difficult situation can arise for trustees of irrevocable life insurance trusts, for example, when the trust has minimal assets, the policy has little cash value, there's no money to pay premiums



and the beneficiaries and settlor have abandoned the trust. Many times in such cases, no successor trustee wants to get involved. The legislation is designed to provide an orderly procedure to fix similar situations while still preserving the rights of the settlor and trust beneficiaries.

The 2019 legislation also clarifies that notice to all fiduciaries is required when a trust is modified or terminated by consent of the beneficiaries and/or the settlor, to prevent the situation in which the beneficiaries and settlor are modifying the trust by a non-judicial settlement agreement without letting the trustee know.<sup>6</sup>

Another 2019 change adds a presumption that a trust is irrevocable unless the terms of the trust instrument expressly reserve the power to revoke or modify.<sup>7</sup> Although infrequent, there are trusts that don't state whether they're irrevocable or revocable, and certain consequences that flow from those trusts are unclear. The new statutory presumptions can always be overcome by including language rebutting the presumption in the trust instrument. South Dakota law provides that "the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary any provisions of general application to trusts and trust administration."<sup>8</sup> Legislation also clarifies that with respect to an investment trust advisor, the advisor can be an entity as well as an individual.<sup>9</sup> Most practitioners had assumed this to be the case, but the legislation confirms this interpretation.

### Recent Judicial Decisions

With respect to judicial decisions, South Dakota statutes are very clear on most trust matters, so there's little litigation on matters set forth in the statutes and very little judicial involvement. One recent case of note, decided May 30, 2017, is *In the Matter of Elizabeth A. Briggs Revocable Living Trust*.<sup>10</sup> South Dakota law allows a trustee, trust advisor, trust protector or settlor to send a copy of the trust instrument and a notice informing the recipient of the trust's existence, of the trustee's name and address and that the recipient has 60 days to start a proceeding contesting the validity of the trust.<sup>11</sup> In this case, Elizabeth Briggs had twice amended her revocable trusts to expressly omit first her son and then the son's daughter from the disposition of assets on Elizabeth's death. Under

SDCL 55-4-57, after Elizabeth's death, the attorney representing her estate sent the descendants the specified notice of 60 days to commence judicial proceedings, and no proceeding was commenced. The son later started an action alleging lack of capacity and undue influence, and the South Dakota Supreme Court, in its first opportunity to address SDCL 55-4-57, concluded that the son's claims were barred and that SDCL 55-4-57 "operate[s] as a statute of limitations or statute of repose that bar[s] untimely judicial proceedings contesting the valid creation of trusts and trust amendments." The court concluded that the incapacity and undue influence claims were barred as

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actions to contest the "validity" of the trust.<sup>12</sup> While in this case, a post-death notice was provided, it should be noted that SDCL 55-4-57 has no restrictions and may be used to limit contests by giving a pre-death notice to potential beneficiaries who may wish to contest the validity of a trust. Indeed, such cases many times turn on the settlor's capacity and intentions, and a court is in a better position to judge such capacity and intentions during the settlor's life when the settlor herself can be examined than after her death, when usually only third-party testimony is available.

In addition to the 60 days after notice requirement of SDCL 55-4-57, the statute also provides that if notice isn't given, a claimant has one year after the settlor's death to commence an action to contest the validity of the creation of the trust or amendment thereto. This statute was also held to bar an action to contest a revocable trust that became irrevocable at



death in *In re Wintersteen Revocable Trust Agreement*,<sup>13</sup> filed Feb. 7, 2018, with the South Dakota Supreme Court, finding the statute operated as a statute of repose that prohibited the relation back doctrine to allow amended pleadings.

In a more recent case, *In re Cameron Trust*,<sup>14</sup> the South Dakota Supreme Court affirmed a trust's spendthrift provisions and refused to give full faith and credit to a California order requiring payment of a child support obligation from the trust. The court, while recognizing the unique facts and 10-year procedural history of the proceedings leading to the California order, affirmed the validity of spendthrift clauses of South Dakota trusts and their prohibition of compelling direct payments to creditors. The court stated:

Our legislature has placed formidable barriers between creditor claims and trust funds protected by a spendthrift provision (citing SDCL 55-1-41, 55-1-35) . . . [and] has emphatically rejected even the specter of an argument that would allow a child support creditor to reach trust funds protected by a spendthrift provision.<sup>15</sup>

The court did recognize that a South Dakota domestic asset protection trust (DAPT) grantor couldn't transfer assets into a DAPT to avoid pre-existing child support obligations (SDCL 55-16-15) but stated that wasn't the situation in this case.

### Government Commitment

South Dakota is committed to remaining in the top tier of trust jurisdictions, and its legislature and judiciary actions and interpretations help maintain this status. The executive branch is also dedicated to making South Dakota a "welcoming" state. As indicated, part of the framework of South Dakota government is the long time appointment of the Governor's Task Force, which has been continuously renewed over the last 19 years by four governors. The executive branch also strongly emphasizes South Dakota's attributes as a state with no state income tax on individuals, corporations or trusts and as a state with strong fiscal attributes. South Dakota has had a balanced budget every year since statehood in 1889. Both Standard & Poor's Global and Moody's

investors have recently reaffirmed South Dakota's AAA bond rating, and the state's public pension retirement system is 100% fully funded.<sup>16</sup> Such fiscal responsibility and stability should imply that there's little concern that state revenue decreases will encourage the income taxation of trusts in the future. A provision in the state constitution requires that to impose or increase such taxes, a 2/3 vote of each house of the legislature would be required.

The South Dakota trust industry, including through the South Dakota Trust Association, works with the legislative, judicial and executive branches to continuously improve the experience in the state for trusts and trust companies. Recent developments, including those that were discussed in this article, evidence the successes. 

### Endnotes

1. Mark Merric and Daniel G. Worthington, "Which Situs is Best in 2018?" *Trusts & Estates* (January 2018).
2. Terry N. Prendergast, "South Dakota Special Spousal Property Trusts: South Dakota 'Steps-Up' to the Plate and Hits a Home Run for Surviving Spouses," 61 *S.D. L. Rev.* 431 (2016).
3. SDCL 55-17-5.
4. Thomas E. Simmons, "Conflict of Interest Infected Virtual Representatives and a Cure," 64 *S.D. L. Rev.* 1 (2019).
5. SDCL 55-3-16; 55-3-171, 21-22-12.
6. SDCL 55-3-24.
7. SDCL 55-3-6.
8. SDCL 55-1-53.
9. SDCL 55-16-5.
10. *In the Matter of Elizabeth A. Briggs Revocable Living Trust*, 898 N.W.2d 465 (2017).
11. SDCL 55-4-57.
12. The son later attempted to challenge the trust in federal court alleging a claim for tortious interference with inheritance or expected inheritance, but the South Dakota Supreme Court on a certified question didn't recognize such a cause of action under South Dakota law. *Briggs v. Briggs*, 2019 S.D. 37 (July 2, 2019).
13. *In re Wintersteen Revocable Trust Agreement*, 907 N.W.2d 785 (2018).
14. *In re Cameron Trust*, 2019 S.D. 35 (June 26, 2019).
15. *Ibid.*, Slip. op., at p. 12 (citing SDCL 55-1-25).
16. South Dakota State News, "South Dakota Maintains Highest Credit Rating," <https://news.sd.gov/newsitem.aspx?id=24485>; South Dakota Retirement System (SDRS), "Comprehensive Annual Financial Report 2018," <https://sdrs.sd.gov/docs/CAFR2018.pdf>.